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ABSTRACT

Kentucky legislation that has restructured the business management of the state's public colleges and universities is discussed. Attention is directed to: conditions in Kentucky prior to the passage of H.B. 622; the events surrounding the development of the legislation; the effects of the legislation on Kentucky's eight universities and 13 community colleges; conditions that could jeopardize the effects of the legislation; and the implication for other states of Kentucky's changes. After reviewing conditions in universities management that were common in Kentucky, the following areas affected by the legislation are examined: purchasing, capital construction, accounting and auditing, payroll, and affiliated corporations and foundations. It is noted that one effect of H.B. 622 has been the increasing decentralization of higher education administration. Institutional governing boards rather than the state department of finance are now accountable for institutional operations. Another effect of the legislation is that state officials have reassessed their views concerning the ability of institutions to manage their own operations. Prerequisites for passage of H.B. 622 are addressed, and an important implication is cited as "the value of cooperation among the various sectors of state higher education." (SW)

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The Kentucky Experience

IMPROVING RESPONSIVENESS TO FISCAL STRESS

by Jack C. Blanton, Edward A. Carter, and James A . Hyatt

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Improving Responsiveness to Fiscal Stress

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During periods of fiscal stress colleges and universities are frequently forced to make major administrative decisions under severe time and political pressures. In the case of public institutions, the ability to respond effectively to funding reductions is often hampered by state regulations that govern the conduct of institutional affairs. Recently, administrators at public institutions that have experienced funding reductions have requested increased institutional flexibility as a means of responding effectively to the challenges facing their institutions.

State executives, legislators, and agency staff, however, are often confused by the question of institutional flexibility. They are unsure about what benefits will be gained by permitting institutions to operate in a more autonomous manner, and they are apprehensive over the prospect of decreased institutional accountability to the state.

One state that has recently streamlined its administrative procedures in order to increase institutional flexibility is the commonwealth of Kentucky. With the passage of House Bill 622, Kentucky reversed a long-standing trend toward increased state centralization, which has been marked by a steady growth of state regulations and procedures. The sections that follow describe: (1) the conditions in Kentucky prior to the passage of H.B. 622; (2) the events surrounding the development of H.B. 622; (3) the effects of H.B. 622 on Kentucky's eight universities and 13 community colleges; (4) conditions that could jeopardize the bill; and (5) the implication for other states of Kentucky's changes. The discussion of H.B. 622 and the implications of the bill for other states is based on interviews conducted in March 1983 under a grant from the Fund for the Improvement of Postsecondary Education (FIPSE).

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Background

In 1936, Kentucky state government went through a comprehensive reorganization. This reorganization featured a greatly reduced number of government units and provided for a strong finance department in a "strong governor" state. In addition, the reorganization involved the establishment of centralized accounting and procurement functions for the restructured units.

The 1936 reorganization was not originally intended to encompass state colleges and universities. State appropriations to higher education institutions, however, were to be kept in the state treasury, and payment documents against state appropriations were to be paid by a state check through a centralized accounting system.

During the ensuing decades, the state institutions became more deeply mired in the state bureaucracy. By the mid-1970s, all procurement for higher education, including capital projects, was under the central direction and control of the state's department of finance. Almost all university funds, including student fees, were accounted for centrally, and the majority of checks to pay employees and vendors were written centrally. The state maintained its accounting records on a cash basis, the universities on an accrual basis. The two accounting systems had to be reconciled, resulting in frequent confusion about fund balances.

The major complaint of university administrators about the system was the excessive amount of time necessary to process documents through the state government. In response to the state structure, each campus developed a costly administrative apparatus whose prime responsibility was to "push paper" through the state bureaucracy.

Universities Management

In 1982, Kentucky's public colleges were freed from most of the costly oversight of their business affairs. The process of enacting H.B. 622, the "Universities Management Bill," began with the election of John Y. Brown, Jr. as governor in November 1979. Brown's economic development theme was "Kentucky, the state that's run like a business." Making decisions on merit rather than politics was simply a step toward that objective. Governor Brown pledged to rid state government of the question-

able aspects of politics, e.g., job patronage and contractual favors.

Early in his administration, Governor Brown challenged higher education to improve its management practices. He included $400,000 in his 1980–82 budget for an independent assessment of management practices and funding levels of colleges and universities in Kentucky. This initiative concerned many university administrators, who were fearful that the governor's concept of management for colleges and universities was inimical to the higher education process.

Responsibility for implementing the independent management assessment was assigned to the Kentucky Council on Higher Education. The council staff identified six areas for review:

1. Organizational structure of the institutions.

2. Adequacy and utilization of resources.

3. Personnel utilization, evaluation, and promotion practices.

4. Fiscal management practices.

5. Costs that might be inconsistent with mission or not related to education.

6. External management barriers to the operation of the institutions.

The "Big Eight" accounting firm of Price Waterhouse & Co. was selected along with MGT of America, Inc., of Tallahassee, Florida, to conduct the study. In January 1982, the consultants released the report's first phase, which dealt with the question of external management barriers and funding comparisons.

The principal conclusion of the independent consultants was that state rules and regulations were a significant obstacle to the improvement of management at colleges and universities. The report contained numerous examples of state procedures that duplicated institutional activities and were costly to higher education in the state. Purchasing rules and regulations, for example, required that certain purchasing activities be accomplished through the state purchasing office and others through the institutions. In addition, duplicate activities by the state occurred in the payroll process for institutional employees and in the accounting and audit functions.

The release of the report findings stimulated the development of a bill that would separate state colleges and universities from the centralized state administrative apparatus. The bill had the unanimous support of the state colleges and universities.

The topics addressed in the draft legislation were complicated and difficult for those not well versed in the procedures of the department of finance. After numerous alterations in the draft, 23 sponsors for the bill were found in the 100-member state house of representatives. The bill was introduced on February 26, 1982.

Support for the bill by representatives and senators from the home districts of all the colleges and universities was nearly unanimous. The institutions had just gone through a divisive battle over a formula for allocating state appropriations, and H.B. 622 was a mechanism for uniting those institutions behind the common goal of improving higher education management in Kentucky. This rare unanimity became widely known throughout the legislature, and it was a major factor in the passage of the bill.

Several state officials whose "turf" was threatened by the bill were less supportive. The secretary of finance, however, stated that he had no objection to enactment, and the governor's support, combined with that of public universities, helped to diffuse opposition. In addition, the chief lobbyist for the bill had been a member of the governor's cabinet and had considerable credibility with legislative leaders and state officials.

The bill was passed by the house by a vote of 75 to 14 on March 25, 1982, and was then sent to the senate, assigned to committee, and reported out on the same day it was passed by the house. This timing was crucial, since the general assembly was set for adjournment on March 31, 1982.

According to staff who worked for passage of the bill, no problems were encountered in the state senate. It was understood that house concerns would be addressed by an "agreed to" amendment in the senate. On March 29, 1982, two days before adjournment, the bill was passed by the senate by a vote of 36 to 0. Attached to the bill was an investment amendment that represented a compromise on the handling of state monies, reflecting an existing centralized investment program for state funds. The bill was remanded to the house so that concurrence with the senate amendment could be achieved. The amendment passed by a vote of 79 to 6 on March 30, 1982. Governor Brown signed the bill on April 1, 1982.

H.B. 622 affords changes in the business management of Kentucky's public colleges and universities in the following areas:

Purchasing. Responsibility for commodity procurement is vested with the colleges and universities. Before H.B. 622, the institutions were responsible for the purchase of certain items, while the state purchasing division procured other items. Now all purchasing may be accomplished at the campus level. The university purchasing director is bound by the terms of the state's Model Procurement Code, as were the state officials. No longer are the universities required to buy from state central stores certain items that are in great demand and on which a surcharge is imposed for the administrative costs of the centralized unit. Universities and colleges may now initiate or enhance the operations of their own stores. Institutions, however, may still choose to use the services of central stores if greater savings can be achieved by having the state order large quantities of certain items.

Capital Construction. The greatest savings resulting from H.B. 622 has been in the area of capital construction. Prior to H.B. 622, the state government selected and employed architects for capital projects on university campuses. Under that arrangement it was frequently alleged that the selection of architects and engineers sometimes depended on factors other than professional competence. Moreover, the institutions concerned were less than satisfied with the degree of supervision exercised over contractors and consultants, since those individuals were accountable to the state department of finance rather than to the institutions. Under the provisions of H.B. 622, state universities may now select and contract with architects and other consultants. They may also advertise construction projects and award contracts in accordance with

the provisions of the state's Model Procurement Code; this prerogative was formerly vested in the state department of finance. The new procedures have substantially reduced the time between project authorization and completion and have resulted in related cost savings. Management effectiveness and efficiency—i.e., issues of quality and associated costs—have become primary concerns of the institutions.

Accounting and Auditing. The central payment of documents through state government has been discontinued. Under a compromise effected during the enactment of H.B. 622, certain state appropriations must be maintained centrally for investment purposes, but funds are transferred on a daily basis to each university to cover the prior day's checks. All accrual accounting, as prescribed in the legislation, is now accomplished at the campus level. The bill requires the governing boards of each institution to make annual reports to the Kentucky Council on Higher Education in a format that meets the existing requirements of the council's system of uniform financial reporting. The law further prescribes that colleges and universities must annually employ a qualified public accounting firm to conduct a thorough financial audit, as well as an audit that speaks to the institution's compliance with H.B. 622. The state secretary of finance may establish the minimum scope of any such audit.

Payroll. The state treasurer formerly wrote all university payroll checks. Electronic data processing tapes were prepared at the campus level and then sent to the state office at least every other week. The tapes were mounted on the treasurer's computer, and the checks were written and returned to the campus for distribution. Under the new law all payroll checks may now be written at each campus by the university treasurer.

Affiliated Corporations and Foundations. The bill authorizes colleges and universities to have and operate affiliated corporations and foundations. An affiliated corporation is a corporate entity (not a public agency) over which an institution exercises effective control by appointing members to the board of directors. Such corporations also cannot continue to exist or operate effectively without substantial assistance from an institution.

Institutional Option. The institutions have the flexibility to elect all or any number of the provisions of H.B. 622.

Effect of H.B. 622 On Administration

The effect of H.B. 622 on Kentucky higher education administration has been twofold. First, the administration of higher education has become more decentralized. Institutional governing boards rather than the state department of finance are now accountable for institutional operations. By giving institutions flexibility to manage their own affairs, H.B. 622 has increased efficiency in several ways. The option of determining the best value for the money, in terms of services rendered or goods purchased, has enabled institutions to achieve cost savings not only for themselves but for the state as well. Also, the elimination of duplicated procedures has decreased the amount of paperwork and considerably streamlined the bureaucracy. In a similar manner, the state department of finance has changed its focus from pre-audit to post-audit of institutions. When interviewed, an official in the state department of finance noted that this change had allowed the department to concentrate its efforts on major policy issues rather than on the routine processing of paperwork. The department's current effort to establish the minimum scope of the audit required under the bill is an excellent example of how institutional and state officials can work together to insure accountability for state funds.

Second, the fact that institutions cooperated so closely during the passage of H.B. 622 has caused a number of legislators and state officials to reassess their views concerning the ability of institutions to manage their own operations and the willingness of institutions and the Kentucky Council of Higher Education to work together to improve the management of higher education. The attitude of institutional administrators has definitely changed. There is now a sense of unity among institutions and a readiness on the part of administrators to work together on the challenges facing Kentucky higher education.

Furthermore, institutions have assumed responsibility for insuring that the provisions of H.B. 622 are implemented in a consistent manner. After the bill's passage, for example, an interinstitutional committee and five subcommittees were established to (1) gain a full understanding of the bill; (2) suggest ways of implementing the bill; and (3) identify standards of compliance for those institutions choosing to assume responsibility for the various functions authorized by the bill. As noted earlier, the institutions are also working with the state department of finance to establish the minimum scope of the audit required under H.B. 622.

Institutions have the option of implementing all or part of H.B. 622. Decisions on this matter have been based on institutional assessment of the benefits to be derived from implementation and on institutional capability to implement the bill's provisions. To avoid the charge that the bill would burden taxpayers, no institution wanted to accept responsibilities that could not be managed within existing resources (manpower, expertise, space, equipment). Second, institutions chose to move with determination and to make certain that the delegated functions were managed professionally.

Some institutions, such as the University of Kentucky and the University of Louisville, chose to implement all provisions of H.B. 622 because they had the staff necessary to perform the newly delegated functions. Other institutions, mainly the regional ones, chose to exercise only some of the options. These institutions usually declined the provision for capital construction because of a lack of appropriate staff such as planners, architects, draftsmen, and construction supervisors. One institution, Kentucky State University, did not exercise any of the H.B. 622 options, in part to avoid the duplication of functions, such as purchasing, that were already being performed in Frankfort, where both the Council on Higher Education and the university are located.

Administrators at the University of Kentucky indicate that H.B. 622

has had the greatest impact in the areas of purchasing and capital construction because the university is no longer required to purchase certain items through state central stores. As a result, the institution has avoided the state stores' markup of 9 percent. Because the institution previously purchased approximately $1 million per year from central stores, it is now saving about $90,000 annually. The university has also been able to award price contracts through its own store operations for such items as computer paper, chemicals, and printing and development paper at a savings of $100,000 per year. By establishing its own purchasing specifications, the university has also been able to obtain better products at reduced costs. By assuming responsibility for its own purchasing, the university estimates that it will achieve a savings of approximately $500,000 per year.

In the area of capital construction, one of the most important benefits of H.B. 622 has been the saving of time. When capital construction was the responsibility of the state department of finance, it frequently took up to one year to appoint an architect and an additional three months to award a contract. With the passage of H.B. 622, the university has been able to appoint an architect, accept bids, and award a contract in seven months—a time savings of approximately eight months. From July 15, 1982 to March 1983, the university awarded $7 million in contracts, with estimated cost savings of approximately $445,000 resulting from reduced time requirements.

Because of the size and scope of its operations, the University of Kentucky has staff available to achieve cost savings by assuming total responsibility for its purchasing and capital construction activities. Other institutions in the state, such as Northern Kentucky and Western Kentucky, have chosen to achieve similar savings in the purchasing area by forming consortia with other state institutions, including the University of Kentucky and the University of Louisville. Such interinstitutional cooperation has helped the institutions to make effective use of the bill's provisions. While it is still too early to determine the full extent of savings resulting from H.B. 622, it appears that the institutions have taken the initiative to improve the efficiency and effectiveness of operations by working together.

Prerequisites for Passage

The development and passage of H.B. 622 resulted from a number of factors. First, there was the surprise election of an unconventional governor who challenged higher education to improve its management practices. Second, the introduction of the bill followed a bitter battle among universities over a funding formula for higher education. Third, the university presidents unanimously supported the bill's passage. Fourth, no critic could provide evidence that the quality of administration would diminish under the newly decentralized procedures. Fifth, since H.B. 622 was presented in the legislature when the session was near adjournment, passage of the legislation had to proceed rapidly. Sixth, the bill was actively supported and tracked daily, and the contents were agreed upon by all institutions. In the absence of any of these factors, it is unlikely that the bill would have passed.

Conditions that Could Jeopardize the Changes

If any one of the institutions that have elected to follow H.B. 622 fails to comply with its provisions, the gains made under it could be nullified. To minimize the chance of this occurring, the participating institutions have established a committee and subcommittees to determine the best method for implementing the bill's provisions. In addition, some institutions, such as Western Kentucky, undertook several months of planning and preparation before electing to follow the provisions outlined in the bill.

Another condition that could threaten the bill is a lack of cooperation among institutions, which manifested itself during the state's recent biennial budget process. The fragmentation of interests, according to one legislative staff member, could undermine the institutions' standing with the governor and the legislature.

The Kentucky funding formula adopted in fall 1983 represents a step in the right direction. The formula was revised to encompass more adequately the activities defined in an institution's mission. The revision process involved representatives from the Kentucky Council on Higher Education, the state, and the various institutions, repeating the cooperation that marked the development and passage of H.B. 622.

Implications for Other States

The extent to which the experience in Kentucky may be of value to other states depends on the degree to which higher education is centralized at the state level in those states. Clearly, the changes in Kentucky were designed to improve operational efficiency by reducing state oversight and costly duplication of institutional activities. Other states with similar systems can benefit from the Kentucky experience by examining the costs and usefulness of state activities that duplicate institutional functions such as purchasing and capital construction. Such information, like that contained in the Price Waterhouse study, can help to demonstrate the value of decentralization. From the perspective of a state agency, the Kentucky experience highlights how states and institutions can reduce costs and improve accountability for state funds by shifting the emphasis from a pre- to a post-audit of institutional expenditures.

Perhaps the most important lesson to be learned here is the value of cooperation among the various sectors of state higher education. This cooperative effort continued even after passage of H.B. 622 as institutional representatives and state officials worked together to insure that the various provisions were implemented in a consistent and responsible manner. In Kentucky responsible groups worked together for the benefit of the state, creating in a period of declining resources an important model for all administrators in public higher education. ◆

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